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DIRECTORATE OF
INTELLIGENCE

Intelligence Report

The Economic Situation in South Vietnam (Biweekly)

State Dept. review completed

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CENTRAL INTELLIGENCE AGENCY
Directorate of IntelligenceThe Economic Situation in South VietnamSummary

The economic situation in South Vietnam has deteriorated considerably during recent months. During the first four months of 1970 prices increased 16 percent, or at an annual rate of more than 50 percent, the highest since 1966. Confidence in the piaster is at a very low level with the black market value less than one third of the official rate. Foreign exchange reserves are declining and by the end of April were at the lowest level since early 1966. The cumulative effect of inflation and the government's failure to take decisive anti-inflationary measures have made economic problems a real factor in political stability for the first time. Above all, there are the additional financial and psychological pressures resulting from the Vietnamization of the war.

During the two weeks ending 11 May Saigon retail prices declined one percent from the average price level for April. Black market dollar and gold prices declined on 8 May to the lowest levels in several weeks, but by 11 May had begun to climb again.

ANNEX: Monthly and Weekly Currency and Gold Prices
(Graph)

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Economic Deterioration

1. Since October 1969 the economic situation in South Vietnam has been deteriorating steadily. Retail prices in Saigon have risen about 30 percent; half of this increase occurred during the first four months of 1970, and at this rate prices would rise at least 50 percent during the full year. Accompanying the recent rise in retail prices has been a fantastic increase in the black market rates for dollars and gold. The price of dollars soared from 225 piasters per dollar in September 1969 to 424 piasters in April 1970 -- an all-time high. Similarly, the rate for gold jumped from about 310 to 514 piasters per dollar. Although these rates have since declined somewhat, they still are extremely high. The recent high rates suggest, among other things, an acceleration of capital flight. Although the government previously has experienced serious economic problems, there is reason to believe that the cumulative effects of five years of inflation averaging more than 35 percent annually added to other economic as well as political problems are contributing to political instability.

2. These problems result from a number of factors among which are speculation resulting from expectations of devaluation, uncertainties created by US withdrawal, government mismanagement of economic affairs, and the sharp increase in austerity taxes on imports last October which resulted in price increases and an increased demand for dollars to pay for smuggled imports. The importance of speculation in the rise in prices is indicated by the fact that prices have increased much more rapidly than the money supply. Speculation about devaluation also has been the major factor behind the soaring black market rates. In addition, confidence in the economy has been lessened as a result of the drawdown in foreign exchange reserves. Largely because of the high level of imports, also based on speculation, during November 1969 - January 1970, central bank exchange reserves (including gold and escrow accounts) now total only \$200 million compared with roughly \$300 million a year ago. Current reserves are equivalent

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to only about three months' total imports (including those financed by the US) at the 1969 level and about six months' imports at the level financed by the GVN in 1969.

3. Although the unusually rapid inflation of recent months appears to be due primarily to speculation, more basic sources of inflationary pressure are likely to come into play soon. Government expenditures are bound to rise to finance new military and civilian programs. The Vietnamization process will place additional strains on the economy. These strains result from the fact that the buildup of the Vietnamese armed forces necessitates increased government expenditures. Moreover, the withdrawal of US forces will eventually reduce foreign exchange earnings which are needed to finance imports to control inflation and to generate revenues. Other programs not directly connected with Vietnamization, such as land reform, also will require increased expenditures. Preliminary estimates of Vietnam's current financial situation by US officials in Saigon are that a 30 percent rate of inflation is probable this year even without accounting for the increased expenditures and shortfalls in revenues they anticipate. A sizable supplemental budget for 1970 already is being drawn up, and another major increase in spending may occur if the government decides that a pay increase for government employees is necessary to lift sagging morale.

4. Although aware of the impending crisis for several months, the government has been unable to draw up a comprehensive program. Indeed, the Supreme Court recently declared the October 1969 decree raising austerity taxes on imports unconstitutional, and the National Assembly has yet to complete passage of legislation to replace the decree. If this bill is not approved, revenues from imports, which account for about 60 percent of total national revenues, could be cut in half. The government apparently believes that a substantial increase in domestic revenues, such as income and excise taxes, could be achieved by more effective tax administration, but the domestic revenue base is small and the government's capability to collect taxes is very limited. A devaluation of the

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piaster, such as occurred in mid-1966, probably would be the most effective stabilization measure the government could take. For political reasons, however, the government is not in favor of devaluation, which would result in an initial sharp increase in prices. Other anti-inflationary measures reportedly are being considered, but detailed plans apparently have not yet been worked out. There will be real political problems involved in implementing any new measures. President Thieu cannot simply promulgate economic reforms by decree. Legislative approval is required, and it is doubtful that the National Assembly will be enthusiastic about any belt-tightening measures. President Thieu's present strategy is to seek from the National Assembly a "loi cadre" (program law, or enabling legislation) which would grant the executive the authority to act by decree in the economic field for a period of several months. A similar request was rejected in March 1968, and it is quite possible that the loi cadre could get bogged down in the legislature or, if approved, may too closely circumscribe the power of the government to act.

5. For the South Vietnamese, the easiest way to cope with their economic problems would be to obtain an increase in US aid. An increase in US aid, either by financing a larger share of total imports or by making a direct grant for budgetary support, would greatly benefit South Vietnam in the short run by allowing a buildup of foreign exchange reserves and by cutting the budget deficit. As shown in the following tabulation, the US economic assistance program combined with US Government purchases of piasters for official and personal uses in the country provided South Vietnam roughly \$800 million annually during 1966-69 in balance of payments support. Counterpart funds from the sale of Commercial Import Program (CIP) and Food for Peace (FFP) (Title I) imports also provided large amounts of piasters to reduce the government's budget deficit.

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US Aid and Piaster Purchases, 1965-69
(million dollars)

	<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>
CIP	180	233	201	118	177
FFP - Title Ia/	49	128	166	198	88
FFP - Title IIb/	10	24	33	37	28
Project aidc/	41	66	40	158	149
Total Aid	<u>280</u>	<u>451</u>	<u>440</u>	<u>511</u>	<u>442</u>
US Government Purchase of Piasters	NA	337	290	311	347

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- a. Surplus US agricultural commodities.
 - b. Emergency relief.
 - c. Technicians & commodities in support of rural development projects, public works, health, education, etc.

Although increased US aid could prop up the economy during the short run, it also would make South Vietnam even more dependent on outside help and thus would be directly counter to the long-run goal of making the economy self-sufficient. In any case, however, the Vietnamese are going to have to rely heavily on US support not only to maintain a military, paramilitary, police, and civil government structure far in excess of what the economy could hope to support with its own resources, but also to finance additional programs, viewed as desirable by the US.

6. South Vietnam's current economic problems are contributing to political instability within the country, and for the South Vietnamese there are no easy cures other than increased US aid. Clearly, the simplest and most effective solution the Vietnamese could take would be a large devaluation, which

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Thieu apparently is unwilling to risk because the initial price increases accompanying such a devaluation would alienate further the already disgruntled military establishment, bureaucracy, and other salaried groups. At the same time, however, less unpopular half-way measures only feed speculation that more drastic economic measures are about to follow.

Prices

7. Retail prices in Saigon fluctuated during the two weeks ending 11 May, resulting in a net decline of one percent from the average price level during April. During the first four months of the year the USAID monthly average price index for all items rose 16 percent and the index for imported commodities rose 13 percent.

Currency and Gold

8. Free market dollar and gold prices also fluctuated during the two weeks ending 11 May. The price of dollars dropped on 8 May to the lowest level since early March, but by 11 May had begun to climb again, although not to previous levels. The price of gold leaf followed a similar pattern. The net result was a decline in the price of dollars from 413 piasters per dollar on 27 April to 390 piasters per dollar on 11 May. A dollar's worth of gold leaf, which brought 493 piasters on 27 April, dropped to 426 piasters on 8 May but was back up to 469 piasters by 11 May. The rate for MPC (scrip) declined 40 piasters to 190 piasters per dollar on 11 May compared with the official rate of 118 piasters per dollar. According to the embassy, the resumption of the increase in black market rates may reflect the uncertainty regarding the status of the higher austerity taxes on imports decreed last October. The Supreme Court has declared the increase unconstitutional and the legislature has not yet passed the bill submitted by the government to replace the decree. As a result, there apparently are widespread rumors that the government will devalue the piaster if the austerity tax bill is not enacted.

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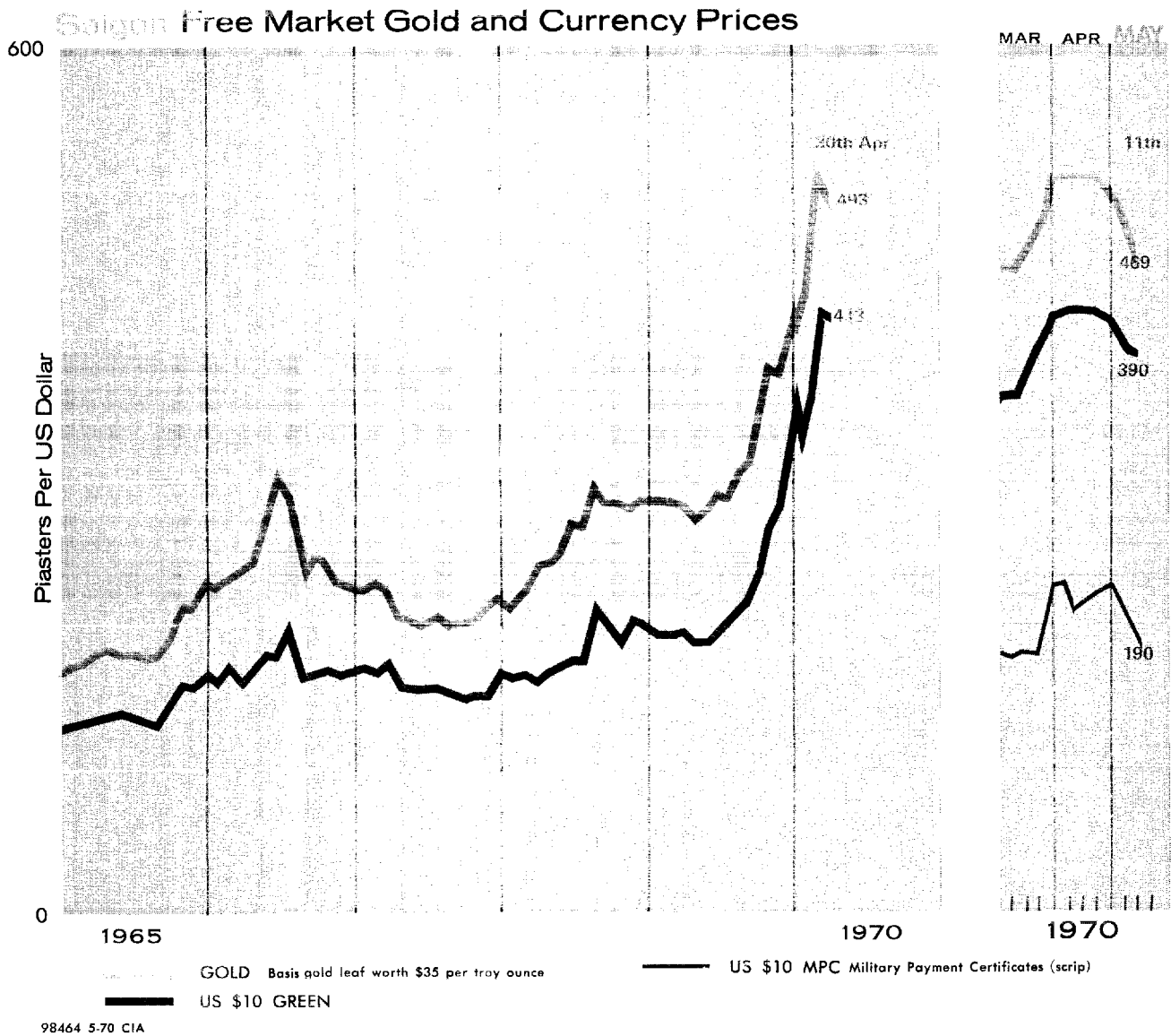
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(A graph on monthly and weekly currency and gold prices is included in the Annex.)

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